

# Retirement Investment, Fiduciary Obligations, and Socially Responsible Investing

George R. Gay, CFP® , AIF® and  
Johann A. Klaassen, Ph.D., AIF®

First Affirmative Financial Network, LLC



# First Affirmative Financial Network

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- **SEC registered Investment Advisor specializing in meeting the needs of socially aware investors since 1988**
- **Over 120 affiliated professionals in 29 states**
- **Clients served nationwide**
- **\$360 million in client assets under management**

# *Retirement Investment, Fiduciary Obligations, and Socially Responsible Investing*

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- 1. What Is SRI?**
- 2. Self-Directed Retirement Plans**
- 3. Defined Contribution Plans**
- 4. Defined Benefit Plans**
- 5. Retirement Investment and SRI**

# What Is SRI?

## SRI is NOT:

- An asset class (e.g., Large Cap US Equity)
- An investment style (e.g., value, growth, blend)

## SRI Is:

“Investing in companies that meet certain baseline standards of social and environmental responsibility; actively engaging those companies to become better, more responsible corporate citizens; and dedicating a portion of assets to community economic development.”

# What Are SRI?

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## Strategies Include

1. Screening (positive and negative)
2. Shareholder Advocacy
3. Community Development Investment

# What Is SRI?

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## Three key limitations:

1. Almost exclusively financial assets
2. Slightly smaller overall market cap
3. Elimination of many cyclical industries means a growth tilt

# Types of Retirement Plan

*Who sets the lists?*

*Who chooses from the lists?*

	Self	Plan Trustee
Self	SD	DC
Plan Trustee	N/A	DB

# Self-Directed Plans

- No particular reason for an individual to refrain from SRI
- Advisors offer two arguments for refusing to help clients pursue SRI strategies:
  1. SRI will necessarily underperform
  2. SRI portfolios cannot be properly diversified

# Self-Directed Plans

## 1. Performance:

There is little evidence of material “return drag” due to SRI screening. We firmly believe that properly constructed SRI portfolios can offer competitive return with competitive risk, and that claims beyond that in either direction have not been conclusively proven to date.

# Self-Directed Plans

## 2. Diversification:

There may be certain asset classes that SRI managers are precluded from holding – but:

- a. Computer modeling allows construction of SRI portfolios on or near the Efficient Frontier, and
- b. There are more SRI managers and funds than there used to be – 200 funds using SRI strategies in 2003, vs 139 in 1997.

# Defined Contribution Plans

Although the focus of attention has historically been on investment returns, according to the Foundation for Fiduciary Studies the fundamental fiduciary duty of a DC plan trustee is to follow a set of “prudent practices”. The Foundation identifies these ten criteria for judging the suitability of an investment manager:

# Defined Contribution Plans

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1. Track record: at least 3 years
2. AUM: \$75 million
3. Organizational stability: no problems or manager turnover for 2 years
4. Style consistency: <20% of holdings in unrelated asset classes
5. High correlation

# Defined Contribution Plans

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6. Fees/expenses not in most expensive quartile
7. Risk-adjusted peer-group performance above median
8. One-year performance above median
9. Three-year performance above median
10. Five-year performance above median

# Defined Contribution Plans

- SRI mutual funds have a “pass rate” comparable to mainstream mutual funds
- SRI funds are not overly expensive: 25% of SRI funds fall into bottom quartile of comparable funds
- Most SRI funds are small: only 24% have more than \$75 million

Data from Morningstar, as of March 31, 2004.

# Defined Contribution Plans

**Three practical problems for SRI inclusion:**

- 1. Adding choices makes decision-making harder, reducing plan participation.**
- 2. Adding only one SRI fund could lead participants to insufficient diversification.**
- 3. Picking which SRI funds to include could be a political minefield.**

# Defined Benefit Plans

Because DB plan trustees make all the manager choices, their fiduciary duties are more stringent – consequently, most simple screening techniques and community investment strategies are out of bounds.

But sophisticated weighting programs (e.g. Innovest) and shareholder advocacy (e.g. CalPERS) are distinct possibilities.

# Defined Benefit Plans

## Three key questions:

1. May a state pension plan defy state law to invest in proscribed companies, industries, or countries?
2. Should a state pension plan own stock in a company the state's Attorney General is suing?
3. Must a state pension plan vote its proxies in a fashion consistent with governmental policies regarding healthcare, pollution, or corporate citizenship?

# Defined Benefit Plans

- We believe that DB plan trustees have substantially the same obligations as a DC plan trustee – and many of the same problems.
- The problems which appear to prevent implementation of SRI strategies in DB plans are practical difficulties, not conflicts with fiduciary duty.

# Retirement Investment and SRI

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**All plan trustees have two obligations:**

- 1. To conduct due diligence on managers, products, and processes**
- 2. To vote the shares held within the plan**

**And therefore, plan trustees have these options:**

# Retirement Investment and SRI

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- 1a. Trustees of all plans have the authority to employ SRI strategies, as long as financial criteria are met.**
  
- 1b. Trustees of DC plans have the authority to offer community development investments, as long as financial criteria are met.**

# Retirement Investment and SRI

- 2a. Trustees of all plans have the authority to disclose proxy votes.**
- 2b. Trustees of all plans have the authority to develop and publish proxy voting guidelines.**
- 2c. Trustees of all plans have the authority to enter dialogue with corporate management on matters of shareowner concern.**
- 2d. Trustees of all plans have the authority to sponsor shareholder resolutions.**

# Retirement Investment and SRI

In the end, fiduciary prudence is not determined by what you do, why you do it, or even how it turns out, but by how you design a process that you can consistently apply across all products and strategies, with appropriate concerns for the needs and risk tolerance of the plan and its beneficiaries.

# *Thank You*

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**George R. Gay, CFP® , AIF®**

**CEO, Chairman of Investment  
Committee**

**First Affirmative Financial Network**

**[georgegay@firstaffirmative.com](mailto:georgegay@firstaffirmative.com)**

**Johann A. Klaassen, Ph.D., AIF®**

**VP, Managed Account Programs**

**First Affirmative Financial Network**

**[johann@firstaffirmative.com](mailto:johann@firstaffirmative.com)**

